INDEX

307-991—68——1

CITATIONS

In the Supreme Court of the United States

OCTOBER TERM, 1967

No. 1049

FEDERAL TRADE COMMISSION, PETITIONER

v.

TEXACO, INC. AND THE B. F. GOODRICH COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE FEDERAL TRADE COMMISSION

OPINIONS BELOW

The opinion of the court of appeals (App., Vol. VI, 106–120) is reported at 383 F. 2d 942. The opinion (App., Vol. VI, 77–93) and final order (App., Vol. VI, 94–96) of the Federal Trade Commission are not officially reported. The prior opinions of the court of appeals (App., Vol. VI, 1–20) and of this Court are reported at 336 F. 2d 754 and 381 U.S. 739. The prior opinions of the Federal Trade Commission (App., 175–186; 302–303) are reported at 58 F.T.C. 1176 and 62 F.T.C. 1172.

JURISDICTION

The judgment of the court of appeals was entered on September 25, 1967 (App., Vol. VI, 121). On December 14, 1967, Mr. Chief Justice Warren extended the time for filing a petition for a writ of certiorari to and including January 25, 1968. The petition was filed on the latter date and was granted on March 11, 1968 (App., Vol. VI, 122). The jurisdiction of this Court rests on 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether, under the standards set forth in *Atlantic Refining Co.* v. *Federal Trade Commission*, 381 U.S. 357, the Federal Trade Commission was warranted in concluding that it is an unfair method of competition in violation of Section 5 of the Federal Trade Commission Act for a major oil company, which has dominant economic power over its dealers, and a major rubber company, to enter into an agreement whereby the oil company promotes and takes steps to induce its dealers to purchase the rubber company's tires, batteries and automotive accessories, in return for a commission on all such sales.

STATUTE INVOLVED

Section 5 of the Federal Trade Commission Act, 15 U.S.C. 45, provides, in pertinent part:

> Unfair methods of competition in commerce, and unfair or deceptive acts or practices in commerce, are declared unlawful. * * * The Commission is empowered and directed to prevent persons, partnerships, or corporations * * * from using unfair methods of competition in

commerce and unfair or deceptive acts or practices in commerce.

STATEMENT

This is one of three related proceedings in which the Federal Trade Commission has prohibited the use of a sales-commission arrangement between a major oil company and a leading producer of tires, batteries and automotive accessories ("TBA") for the distribution of TBA through the retail gasoline service stations of the oil company. Under such an arrangement, an oil company agrees to promote the sale to its dealers of a tire company's TBA (known as "sponsored TBA") in return for a commission on the goods sold. In *Atlantic Refining Co.* v. *Federal Trade Commission*, 381 U.S. 357, this Court sustained the Commission's order against the Goodyear Tire and Rubber Company and the Atlantic Refining Company. In *Shell Oil Company* v. *Federal Trade Commission,* 360 F. 2d 470, certiorari denied, 385 U.S. 1002, the Court of Appeals for the Fifth Circuit, subsequent to this Court's decision in *Atlantic,* sustained the Commission's order against the Shell Oil Company and the Firestone Tire and Rubber Company. In both of these cases the respondent oil and tire companies were enjoined from participating in any such sales commission arrangements with any other company.

The present case involves the validity of sales-commission arrangements for the distribution of TBA that the respondent Texaco, Inc. ("Texaco") has entered into with respondent B. F. Goodrich Co. ("Goodrich") and with the Firestone Tire and Rub-

ber Company ("Firestone").[1] The Commission held that these arrangements were unfair methods of competition and unfair acts and practices in violation of Section 5 of the Federal Trade Commission Act and entered a cease-and-desist order. The Court of Appeals for the District of Columbia Circuit set aside the order and instructed the Commission to dismiss the complaint.[2]

A. THE TEXACO-GOODRICH ARRANGEMENT

Texaco, one of the nation's largest petroleum companies, sells its products to approximately 30,000 service stations or about 16.5 percent of all service stations in the United States (App. Vol. I, 221). Texaco's retail dealers are primarily divided into two categories: lessee dealers who lease their service stations directly from Texaco, and contract dealers who either own their own stations or lease them from third parties. The usual lease is for a term of one year, and thereafter from year to year, subject to termination by either party at the end of any year on ten days' notice. The lease contains so-called "house-keeping"

[1] Firestone is subject to a final order of the Commission prohibiting its use of a sales commission plan with any oil company. See *Shell Oil Company* v. *Federal Trade Commission*, 360 F. 2d 470, 474 (C.A. 5), certiorari denied, 385 U.S. 1002.

[2] That court also had reversed a prior cease-and-desist order against these companies (62 FTC 1197; 336 F. 2d 754). The Commission petitioned for a writ of certiorari and, following the decision in the companion *Atlantic Refining* case, the Court granted the petition, vacated the judgment of the court of appeals and directed that the case be remanded to the Commission for further proceedings in light of *Atlantic*. *Federal Trade Commission* v. *Texaco, Inc.*, 381 U.S. 739. The order here under review was issued pursuant to this remand.

provisions relating to the use, maintenance and general appearance of the station. Breach of any provision of the lease by the lessee constitutes grounds for immediate termination by Texaco without notice to the lessee (App., Vol. IV, 20–21). Contract dealers lease pumps and other equipment from Texaco.

Both lessee and contract dealers enter into "agreements of sale" with Texaco for the purchase of gasoline and other petroleum products; the agreement prescribes annual minimum and maximum purchases at current prices. This agreement also runs from year to year and is terminable upon 30 days' notice. In addition, it is automatically cancelled if the lease of a dealer is terminated and may be terminated by either party for failure of the other party to perform strictly any of the obligations (App., Vol. IV, 22–23). All of these contracts apparently are standard documents prepared by Texaco.

Goodrich is one of the four largest rubber companies in the United States. It manufactures a full line of tires, tubes and related products and purchases for resale batteries labelled BFG and a full line of automotive accessories which are sold under their own nationally advertised brand names. It distributes these products through company-owned stores, independent dealers and thousands of service stations throughout the United States. (App., Vol. I, 217–218, 304).

The Texaco-Goodrich agreement, which was entered into in 1943, provides that Goodrich will pay Texaco a commission on all purchases of Goodrich TBA by Texaco consignees, dealers or distributors in "consideration of the aid to be given and the services to

be rendered by your [Texaco's] sales organization in connection with promoting the sale of Goodrich products" (App., Vol. IV, 6).[a] The commission is 10 percent on purchases of sponsored TBA by Texaco retail dealers and 7.5 percent on purchases by its wholesale distributors. The total volume of sponsored TBA sold to Texaco dealers by Goodrich and Firestone in the period 1952–1956 was $245 million; in 1956 alone it was almost $59 million. Consequently, the total TBA commissions received by Texaco in the period 1952–1956 were almost $22 million (App., Vol. I, 209–210).

Texaco has engaged in the following promotional activities, among others, in performing its obligations under the sales commission agreements: (a) when interviewing prospective dealers, Texaco emphasized the importance of TBA and recommended sponsored products (App., Vol. I, 208, 216); (b) Texaco's sales campaign materials and literature discussing the importance of TBA utilized and recommended sponsored products (App., Vol. I, 208, 345–346, 361–362); (c) Goodrich was notified of new dealers and stations before they began operation, thus enabling Goodrich to solicit their business in advance of competitors (App., Vol. I, 208, 399–400, 511, 674, 701–702, 723; Vol. VI, 90); (d) Texaco salesmen promoted sponsored TBA in their day-to-day contacts with the dealers (App., Vol. I, 329, 412, 526–527; Vol. VI, 90); and (e) Texaco and tire company salesmen called on dealers together (App., Vol. I, 528, 680).

Moreover, Goodrich reported each dealer's indi-

[a] The agreement with Firestone was substantially identical (App., Vol. IV, 16–17).

vidual purchases of sponsored TBA to Texaco (App., Vol. I, 316–317, 460; Vol. IV, 70E–70F, 74–78). Thus Texaco is informed of each dealer's purchases, and considers this fact in evaluating service stations when deciding whether to renew their leases (App., Vol. IV, 49; Vol. VI, 91).

B. THE COMMISSION'S DECISION

After reconsideration of the record pursuant to this Court's remand order (381 U.S. 739), the Commission issued a new opinion holding the sales commission plan to be an unfair method of competition. The Commission began by analyzing this Court's decision in *Atlantic Refining.* The essence of that decision, according to the Commission, was that "while coercive practices aggravate the restraint imposed by the sales commission plan, it is the oil company's power over its dealers, derived from the contractual relationship between them, and the utilization of that power through the performance of the promotional services required by the sales commission agreement, which renders the sales commission plan unlawful" (App., Vol. VI, 84). The Commission then ruled that the economic dependence of Texaco dealers is the same as that of Atlantic dealers, noting that the contractual relationships were almost identical in both cases (App., Vol. VI, 89–90). The Commission concluded that it was unnecessary for the oil company to engage in "overtly coercive tactics" in order effectively to exercise its dominant economic power over its dealers; it stated that the consequence of Texaco's promo-

307-991—68——3

tional activities was to "impress upon Texaco dealers, through constant repetition and in a variety of ways, that Texaco, whose favor the dealers must court, has a strong interest in their purchase of the sponsored TBA products" (App., Vol. VI, 90).

The Commission reviewed generally the extent to which the sales-commission arrangement had been successful, but concluded that no extensive economic analysis was required since the amount of commerce involved was substantially greater than that in the *Atlantic* case. It pointed to evidence that competing sellers of TBA had been foreclosed from the Texaco service station market, including testimony by competing TBA suppliers that the Texaco dealers did not feel that they were free to buy from non-sponsored suppliers (App., Vol. VI, 91).

The Commission's order, identical in scope to that approved by this Court in *Atlantic*, enjoined both Texaco and Goodrich from entering into a TBA sales-commission contract with any other company (App., Vol. VI, 94-96).

C. THE COURT OF APPEALS' DECISION

The court of appeals set aside the order and instructed the Commission to dismiss the complaint. The court read the *Atlantic* decision as establishing "three essential components" for a sales-commission agreement to be illegal: (a) the oil company's dominant economic power over its dealers; (b) exercise of that power; and (c) anticompetitive effects of using that power (App., Vol. VI, 110).

The court upheld the Commission's conclusion that Texaco has dominant economic power over its dealers (App., Vol. VI, 111–112, 119). On the question of exercise of that power, the court held:

> We can glean nothing from the utterances of the Supreme Court which alters the basic rule that a finding of coercion is the threshold requirement of a determination of exercise of dominant economic power. [App., Vol. VI, 112].

The court compared each of Texaco's promotional practices with those used by Atlantic and concluded that Texaco's practices could not be found to be coercive (App., Vol. VI, 114–115). Nor, in the court's judgment, did any of these practices indicate illegal exploitation by Texaco of its service station market. Therefore, it concluded, "we do not find that Texaco used its controlling economic power to compel its dealers to purchase sponsored TBA." (App., Vol. VI, 115). On the question of competitive effect, the court held that "there is an absence of substantial evidence which supports a finding of anticompetitive effects." (App., Vol. VI, 119). Since the court believed that the Commission had had sufficient opportunity to develop the record but had failed to do so adequately, it ordered the Commission to dismiss the complaint.[6] (App., Vol. VI, 119–120).

[6] The Commission has not challenged the action of the court of appeals in setting aside paragraphs 5 and 6 of the order against Texaco, which prohibited the latter from overtly coercing its dealers (App., Vol. I, 231–232; Vol. VI, 95, 119 (n. 16)).

SUMMARY OF ARGUMENT

The Commission correctly concluded that the sales-commission arrangement between Texaco and Goodrich is an unfair method of competition. The court of appeals in setting aside the Commission's order made two fundamental errors. First, it ignored the broad authority of the Federal Trade Commission to define unfair methods of competition. Second, it misapplied this Court's decision in *Atlantic Refining Co.* v. *Federal Trade Commission*, 381 U.S. 357, and required the Commission to predicate a Section 5 violation in this case upon proof of promotional practices which were virtually identical to those found in *Atlantic*. The court below thus ignored both the experience with the anticompetitive potential of sales-commission agreements which the Commission has gained in three related cases involving this issue and this Court's expressed concern in *Atlantic* with the adverse effects of the widespread use of such agreements.

The Commission determined that Texaco has dominant economic power over its dealers, a finding accepted by the court of appeals. Within this framework of dominant economic power, the Commission concluded that Texaco's promotional activities in support of sponsored TBA necessarily make the dealers aware of Texaco's interest in the purchase of such TBA. The Commission thus recognized that the basic evil of the sales-commission plan is the exercise of the oil company's economic power, not the particular means by which it is exercised. The court of appeals, however, thought that a finding of coercion was required and therefore concluded that Texaco had not illegally ex-

ercised its economic power. Such a requirement is based on a misinterpretation of Section 5 and is plainly inconsistent with the standards set forth in *Atlantic*.

The Commission was also correct in concluding that the Texaco-Goodrich agreement has anticompetitive effects. The Commission was not obliged to undertake an extended economic analysis. It is sufficient that a "not insignificant" amount of commerce is involved in the sales-commission scheme. Since the result of the sales-commission arrangements is to preclude dealers from selecting TBA solely on the comparative merits of the competing brands, these arrangements interfere with the free functioning of the market. The sales-commission arrangements make it more difficult for smaller TBA producers and distributors to compete in the substantial market represented by service stations. This Court in *Atlantic* was concerned with such anticompetitive consequences of the widespread use of sales-commission agreements, not with the particular practices used by Atlantic and Goodyear in performing them.

ARGUMENT[4]

THE COMMISSION CORRECTLY HELD THAT TEXACO'S SALES-COMMISSION ARRANGEMENTS CONSTITUTE UNFAIR METHODS OF COMPETITION, IN VIOLATION OF SECTION 5 OF THE FEDERAL TRADE COMMISSION ACT

This Court has consistently recognized and upheld the broad discretion of the Federal Trade Commission to define unfair methods of competition under Section 5 of the Federal Trade Commission Act. See,

[4] Although for ease of presentation our argument is focused primarily on the arrangements between Texaco and Goodrich, it applies equally to those between Texaco and Firestone.

e.g., Federal Trade Commission v. *Brown Shoe Co.*, 384 U.S. 316, 321–322; *Federal Trade Commission* v. *Motion Picture Adv. Co.*, 344 U.S. 392, 394–395. The breadth of this authority is particularly relevant here because, in concluding that the Texaco sales-commission arrangements constitute unfair methods of competition, the Commission had the benefit of the experience it had gained through its comprehensive studies of the use and effect of such arrangements made in the related *Atlantic* and *Shell* cases. The Commission concluded (App., Vol. VI, 92) that "the gravest danger to competition presented by the sales commission plans here as in *Atlantic* is in their capacity for hindering competition between sponsored and non-sponsored TBA suppliers." It ruled (*id.* 89) that the "economic dependence of Texaco dealers is no different from that of Atlantic dealers"; and that (*id.* 90) "Texaco's promotional efforts in carrying out its sales commission agreement with Goodrich and Firestone constitute a forceful exercise of its economic power over its dealers. Its consequence is to impress upon Texaco dealers, through constant repetition and in a variety of way, that Texaco, whose favor the dealer must court, has a strong interest in their purchase of the sponsored TBA products." In the light of these findings and the substantial volume of TBA sales made by Texaco dealers under the sales commission arrangements (see *supra*, p. 6; *infra*, pp. 16–17, 23), the Commission was justified in concluding that those arrangements resulted in the same kind of injury to competition that characterized the *Atlantic* and *Shell* sales commission

plans, and were equally illegal. What this Court said in *Federal Trade Commission* v. *Cement Institute,* 333 U.S. 683, 720, is peculiarly appropriate here:

> We are persuaded that the Commission's long and close examination of the questions it here decided has provided it with precisely the experience that fits it for performance of its statutory duty. The kind of specialized knowledge Congress wanted its agency to have was an expertness that would fit it to stop at the threshold every unfair trade practice—the kind of practice which, if left alone, "destroys competition and establishes monopoly." * * *

As we show below, the court of appeals here took far too narrow a view of the Commission's authority, and misinterpreted this Court's *Atlantic* decision. In *Atlantic* this Court held that in reviewing the agency's determination that a sales-commission arrangement is an unfair method of competition, the court "is limited to determining whether the Commission's decision 'has warrant in the record and a reasonable basis in law'" and that "necessarily 'we give great weight to the Commission's conclusion. * * *'" (381 U.S. at 367–368). Under these standards the court of appeals should have upheld the Commission's decision.

That decision rested on three ultimate findings: (a) that Texaco has dominant economic power over its dealers; (b) that in promoting sponsored TBA it exercises that power in ways that make the dealers aware of its interest in their purchase of such TBA; and (c) that substantial anticompetitive effects result from Texaco's performance of the agreements. The

record adequately supports each of these findings and under *Atlantic* they justify the Commission's conclusion that the Texaco sales-commission arrangements constitute unfair methods of competition in violation of Section 5.

A. TEXACO HAS DOMINANT ECONOMIC POWER OVER ITS DEALERS

The Commission found that Texaco retail service station dealers are economically dependent upon Texaco as a result of both the contractual relationship between the dealer and the oil company and the latter's economic power (App., Vol. IV, 89–90). The court of appeals upheld the Commission's conclusion that Texaco has dominant economic power over its dealers (App., Vol. VI, 111–112, 119). While this fact, therefore, is established, it is instructive to examine briefly the nature of that power in order to place the sales-commission arrangement in perspective.

The specific factors from which an oil company derives economic power over its dealers include control over oil and gas supply, short-term leases, sales agreements and equipment loans, control over advertising, leverage from financial promotion, and house-keeping requirements of leases. These factors are inherent in the petroleum distribution system and create a situation where the individual retail dealer is completely dependent for his economic survival on the oil company with which he deals. See *Atlantic*, 381 U.S. at 368; *Simpson* v. *Union Oil Co.*, 377 U.S. 13; *United States* v. *Sun Oil Co.*, 176 F. Supp. 715 (E.D. Pa.). Two of the most significant elements of the oil company's economic power in promoting sponsored TBA

are its complete discretion as to renewal of leases and sales agreements and the general "housekeeping" requirements concerning the station's use, maintenance and appearance. As noted above, *supra*, pp. 4-5, the Texaco lease authorizes Texaco to terminate (1) at the end of any year on ten days' notice, or (2) for any breach in the "housekeeping" requirements. The sales agreement authorizes Texaco to cancel on 30 days' notice at the end of any year. It is only natural that the dealer will be extremely anxious to maintain a harmonious relationship with Texaco, and with its salesmen who represent his direct contact with the company, in order to ensure renewal of the agreements each year.

B. TEXACO'S ACTIVITIES IN PROMOTING SPONSORED TBA ARE AN EXERCISE OF ITS ECONOMIC POWER OVER ITS DEALERS

1. The Commission detailed a number of practices in which Texaco engaged to promote the purchase of sponsored TBA by its dealers (see *supra*, p. 6). It concluded that the "consequence [of these activities] is to impress upon Texaco dealers, through constant repetition and in a variety of ways, that Texaco, whose favor the dealers must court, has a strong interest in their purchase of the sponsored TBA products" (App., Vol. VI, p. 90). This finding is amply supported by the record. The Commission pointed out that "perhaps [the] most effective" factor was the promotion of sponsored TBA by Texaco salesmen in their regular contacts with the dealers (App., Vol. VI, 90-91). Since the salesman is the primary link between the dealer and the company upon which he is so de-

pendent, the salesman's continual promotion of a particular product necessarily will have substantial influence upon the dealer's decision that is unrelated to the relative merits of the product in comparison with competing, unsponsored brands.

These personal contacts by salesmen are supplemented and reinforced by other techniques that remind its dealers constantly of Texaco's interest in their choice of sponsored TBA: sponsored TBA is recommended in Texaco's literature and sales campaign materials (App., Vol. I, 345–346, 361–362); classes and sales demonstrations for dealers utilize only sponsored TBA (App., Vol. I, 361–362; Vol. II, 1258); Texaco emphasizes to prospective dealers the importance of TBA and endorses sponsored products (App., Vol. I, 208, 216).[8]

Texaco can ascertain the size of its dealers' purchases of sponsored TBA from reports it receives from Goodrich and Firestone detailing TBA sales to individual dealers (App., Vol. I, 316–317, 460; Vol. IV, 70E–70F, 74–78). Sales of sponsored TBA, as well as sales of petroleum products, are "a strong" factor in determining whether to renew a particular station lease (App., Vol. IV, 49). It is hardly surprising, in light of Texaco's dominant economic power, that these

[8] Although Texaco purported to operate under a policy, articulated on June 1, 1948, that its dealers were independent businessmen who were not to be forced to handle any particular merchandise (App., Vol. I, 215), this "policy" was only occasionally and informally communicated to the dealers by the Texaco salesmen, and was communicated to a dealer in writing only *after* the dealer had established himself as a successful marketer of lubricating oil. (*Ibid.*)

promotional activities produce substantial purchases of sponsored products by Texaco dealers (see *supra*, p. 6).

2. The court of appeals, however, believed that coercion was a necessary prerequisite to a finding of exercise of economic power. After comparing in detail the evidence in the present case with the techniques employed in the *Atlantic* case for bringing to bear the oil company's economic power upon its dealers, the court concluded that none of the promotional activities utilized here was necessarily coercive and that there was no substantial evidence of actual coercion by Texaco. It therefore held that Texaco had not exercised its concededly dominant economic power. This conclusion rested on a serious misreading of the *Atlantic Refining* decision.[6]

While both the Commission and the court of appeals in *Atlantic* had found that the oil company had engaged in coercive practices, nothing in this Court's

[6] It is also contrary to the analysis of the Fifth Circuit in *Shell Oil Co.* v. *Federal Trade Commission*, *supra*. In *Shell*, in reviewing a markedly similar record, the court found insufficient support for the Commission's finding of coercion, but concluded that this did not "bear directly on the principal issue, the Company's use of its economic power through the sales commission plan to cause its dealers to buy sponsored TBA *even in the absence of overt coercion*" (360 F. 2d at 482–83, emphasis supplied). Conceding that the *Shell* record lacked any such "striking example of abuse of power" as was found in *Atlantic*, the court held that this did not "detract from the less spectacular but solid evidence supporting the Commission's finding that Shell used its economic dominance to cause a substantial number of its dealers to purchase sponsored TBA." 360 F. 2d at 482.

opinion indicated that the use of coercion was the factor which made the arrangement illegal. On the contrary, the Court expressly noted that the Commission's view was that coercive practices were merely "symptomatic of a more fundamental restraint of trade" (381 U.S. at 361) and that illegal "effects on competition flowed from the contract itself." (381 U.S. at 370.) The basic vice of the sales commission plan involved in *Atlantic* was identical to that of the plan in the present case: "the utilization of economic power in one market to curtail competition in another" (381 U.S. at 369). Cf. *Northern Pacific Ry. Co. v. United States,* 356 U.S. 1.

The fundamental evil here, as in *Atlantic,* was the use of the oil company's economic power, not the particular means—whether labeled "coercion" or not—by which it was exercised. But the court of appeals permitted this basic economic vice to be obscured by its pre-occupation with the particular techniques used by Atlantic and Goodyear, the trappings in which the vice was manifested in *Atlantic.* Such an approach to review of the Commission's determinations under Section 5 overlooks the fact that the Commission has been entrusted with the interpretation and application of an economic regulatory statute for the benefit of the entire competitive economy; it constricts the Commission' function to a search for specific acts of culpable conduct as if the agency were administering punishment under a criminal code (see, *e.g.,* App., Vol. VI, 119).

This is the same fundamental misconception of the Commission's role under Section 5 which the majority

of this Court adopted in *Federal Trade Commission* v. *Gratz*, 253 U.S. 421, 427, over the strong dissent of Mr. Justice Brandeis. The Court recently unanimously rejected the *Gratz* approach in *Federal Trade Commission* v. *Brown Shoe Co.*, 384 U.S. 316, 320-321, where it pointed out that "it is now recognized" that "the dissent of Mr. Justice Brandeis in *Gratz*" more accurately defines the Commission's "broad powers to declare trade practices unfair." In *Gratz* Mr. Justice Brandeis stated (253 U.S. at 434-435):

> Instead of attempting to inflict punishment for having done prohibited acts, * * * [Section 5] undertook to preserve competition through supervisory action of the Commission. * * * If it discovered that any business concern had used any practice which would be likely to result in public injury—because in its nature it would tend to aid or develop into a restraint of trade—the Commission was directed to intervene, before any act should be done or condition arise violative of the Anti-Trust Act.

This case presents a graphic illustration of the harmful consequences which can result from the *Gratz* view which the court of appeals took of the Commission's authority. In three related proceedings (see *supra*, p. 3), the Commission determined that, when oil companies have dominant economic power over their dealers, their promotion of sponsored TBA under a sales-commission arrangement constitutes an unfair method of competition under Section 5 because of its pronounced tendency to foreclose competition in the marketing of TBA. In two of those proceedings, judi-

cial review has been completed and Atlantic Refining Company, Shell Oil Company, Goodyear Tire and Rubber Company and Firestone Tire and Rubber Company stand permanently enjoined from participating in any such sales-commission arrangements with any other company. But in the present case, the court below held that Texaco and Goodrich may continue to use essentially identical sales-commission promotional arrangements because the court perceived differences in the indicia of exercise, or in the degree of exercise, of Texaco's power over its dealers.

Thus "without making any investment in distributional facilities or TBA inventory" (App., Vol. VI, 84-85), Texaco would be permitted to continue to receive substantial commissions for promoting the sale of TBA to its service stations while, for example, its smaller competitor, Atlantic Refining Company, is barred from the same economic opportunity; and similarly Goodrich would be allowed to continue to utilize the power which major oil companies have over their dealers in order to obtain advantages in the marketing of Goodrich TBA which are denied to Goodrich's competitors.[7] This is precisely the "arbitrary and inequitable" situation which the Commission pointed out would "create a harmful competitive imbalance among the leading firms" in both the oil and tire industries (App., Vol. VI, 88). Section 5 does not limit

[7] Indeed, the result is completely anomalous in the case of Firestone (with which Texaco also has a sales-commission plan), since the decision below approves the very type of arrangements which the Fifth Circuit's decision in *Shell-Firestone* bars Firestone from utilizing.

the Commission's power to substituting a new competitive imbalance for the original one under which the large tire companies had an advantage over their smaller competitors. This Court's recognition that such distortions of the Commission's function inevitably followed from the *Gratz* interpretation surely has been one important reason for the explicit repudiation of that interpretation (*Brown Shoe Co., supra,* 384 U.S. at 320–321) and the adoption, instead, of a broader view of the Commission's authority, soundly based on the legislative history of Section 5 (see *Atlantic Refining Co., supra,* 381 U.S. at 367). The Commission was amply warranted in ignoring the essentially unimportant distinctions in the manner in which the three oil companies exercised their power over their dealers and instead focusing on the economic consequences of such exercise.

3. In short, the Commission has determined in these three cases that it is an unfair method of competition forbidden by Section 5 for an oil company with dominant power over its dealers to exercise that power under a sales-commission agreement by means of promotional activities which, because of the relationship between the company and the dealers, deny them complete freedom of choice in making their purchases. The Commission's conclusion was justified, as this Court recognized in *Atlantic Refining,* because of "the destructive effect on commerce that would result from the widespread use of these contracts by major oil companies and suppliers" (381 U.S. at 371). *Cf. Standard Oil Co.* v. *United States,* 337 U.S. 293.

While the court below set aside the Commission's ultimate finding that Texaco had exercised its dominant economic power, it did not disturb the bulk of the supporting findings with respect to promotion by Texaco of Goodrich TBA. In particular, the court did not question that the Texaco salesman continually carries the promotional message in his day-to-day contacts with dealers. Nor did the court question the use of statistics on sponsored TBA purchases in evaluating a dealer's performance. But these are highly effective means of exercising economic power, for they go directly to the continuation of the economic relationship between Texaco and the dealer. Where, as here, the effect of the promotional activities of the oil company is to make its dealers aware that the company has a direct interest in their purchase of sponsored TBA, it was reasonable and proper for the Commission to conclude that the oil company has exercised its economic power.

Texaco has been paid substantial commissions without being required to make any investment in distributional facilities or inventory, and "without relieving the TBA supplier of the burden of sales, distribution, and service" (App., Vol. VI, 84-85). In referring to virtually identical "substantial overriding commissions" in *Atlantic*, this Court said (381 U.S. at 376):

> It is difficult to escape the conclusion that there would have been little point in paying substantial commissions to oil companies were it not for their ability to exert power over their wholesalers and dealers * * *

See, also, *Shell Oil Co.* v. *Federal Trade Comm.*, *supra*, 360 F. 2d at 482.

C. TEXACO'S PROMOTION OF SPONSORED TBA UNDER THE SALES COMMISSION AGREEMENT CAUSES SIGNIFICANT ANTICOMPETITIVE CONDITIONS IN THE TBA MARKET

The use of a sales-commission promotional arrangement for the distribution of TBA results in the foreclosure of service station outlets as a market for the sale of products of competing TBA distributors. In *Atlantic* this Court held that it was not necessary for the Commission to engage in extensive economic analysis of the effects of a sales-commission plan once it was determined that a "not insubstantial" amount of commerce is involved. 381 U.S. at 371. Since sales of sponsored TBA to Texaco dealers in one year exceeded total sales to Atlantic dealers during a six-year period (App., Vol. I, 209–210; Vol. VI, 89), the substantiality of commerce requirement was clearly satisfied in this case.

Once he recognizes that Texaco favors the purchase of sponsored products, the dealer, even if he is not coerced, no longer selects his brand of TBA solely on the basis of the comparative merits of the competing products. In the absence of strong countervailing factors the dealer is most likely to acquiesce in Texaco's recommendation to purchase the sponsored product. See *Shell Oil Co.* v. *Federal Trade Commission*, *supra*, 360 F. 2d at 486. As in the case of tying agreements, the selection of the sponsored product is not the result of "a better product or a lower price" but is influenced by "power or leverage in another mar-

ket." *Northern Pacific Ry. Co. v. United States*, *supra*, 356 U.S. at 6. This type of interference with free competitive conditions flows directly from the sales-commission agreement itself. *Atlantic Refining*, *supra*, 381 U.S. at 370.

The fact that some dealers may nonetheless purchase nonsponsored products does not negate the Commission's conclusion that use of the sales-commission plan by oil companies which exercise dominant economic power over their dealers has a significant adverse effect on the free play of competition. The record in this case and the Commission's experience in other cases support the Commission's conclusion that a large number of dealers, subject to repeated reminders that Texaco recommended their purchase of sponsored TBA, would not exercise free choice based on the merits of competing products. This conclusion was supported by testimony of sellers of nonsponsored TBA that they were unable to sell to particular Texaco service stations because of the dealers' expressed concern that Texaco would disapprove of their purchase of nonsponsored products. (App., Vol. I, 565, 567, 653–655, 681, 686, 702; Vol. II, 1043–1044, 1065, 1196, 1288–1289).

The court of appeals, however, said that it could not regard such testimony as "representative" (App., Vol. VI, 118):

> * * * [S]uch a conclusion is not supported by substantial evidence, except in isolated instances which were generally contradicted by overwhelming rebuttal evidence. Nor can we accept the Commission view that the rebuttal testi-

> mony is to be discounted because witnesses are under "pressure" from Texas [see App., Vol. I, 214]. A finding of pressure on witnesses before a tribunal is not one to be lightly inferred and ought not be made without evidence of some kind; none is suggested by the Commission on this score.

The court's error here was not confined merely to the questionable propriety of its disagreeing with the Commission as to the relative weight to be given various testimony and its refusal to permit the Commission to discount the reliability of some of that testimony because of the inhibition inherent in the dominant economic power Texaco has over its dealer witnesses. More fundamentally, the court misconceived the issue before the Commission. The Commission was not required to decide whether the testimony on which it relied was "representative", as the court of appeals used that term.

Under Section 5, the question for the Commission was not whether all Texaco dealers, or most Texaco dealers, felt constrained to purchase sponsored TBA. The Commission had determined, through its examination of the sales-commission method of promoting TBA, that the most significant anticompetitive effect of the practice was the foreclosure to nonsponsored brands of an opportunity to sell in the substantial market represented by dealer outlets of contracting major oil companies. In *Atlantic* this Court recognized "the destructive effect upon commerce that would result from the widespread use of these contracts by major oil companies and suppliers * * *" 381 U.S. at 371. Having identified a significant ten-

dency toward the same anticompetitive effect which had been the principal basis for condemning similar sales-commission arrangements, the Commission was not obliged to await the development of the identifiable foreclosure into a "full-blown" restraint, before concluding that the Texaco-Goodrich arrangement, like is counterparts, was a violation of Section 5. See *Federal Trade Commission* v. *Brown Shoe Co., supra*, 384 U.S. at 321–322; *Federal Trade Commission* v. *Motion Picture Adv. Co., supra*, 344 U.S. at 394–395. Once again the insights of Mr. Justice Brandeis are instructive (*Federal Trade Commission* v. *Gratz, supra*, 253 U.S. at 441–442) (dissenting opinion):

> The purpose of Congress [in enacting Section 5] was to prevent any unfair method which may have been used by any concern in competition from becoming its general practice. It was only by stopping its use before it became a general practice, that the apprehended effect of an unfair method in suppressing competition by destroying rivals could be averted.

This problem is particularly acute here, because one serious anticompetitive consequence of the use of the sales-commission arrangement is that it disables smaller tire companies from competing in the service station market. The three TBA cases have disclosed that only the largest rubber companies in the United States have been able to utilize TBA sales-commission arrangements (App., Vol. VI, 87). The service station has become an increasingly important source for distribution of replacement tires, batteries, and other automobile accessories (App., Vol. VI, 87; see also *Atlantic Refining, supra*, 381 U.S. at 364). When each

independent service station dealer remains free to choose the brands of TBA he wishes to stock, smaller producers and distributors have a greater opportunity to share in this market. When, however, a substantial number of service stations of a major oil company such as Texaco are induced to stock TBA promoted by the company under a sales-commission arrangement with one of the major producers, other producers and distributors no longer have a fair chance to compete for this business. Since the original equipment market for tires is completely dominated at the present time by the five largest producers (Staff Report to the Federal Trade Commission, *Economic Report on the Manufacture and Distribution of Automotive Tires*, pp. 26–27 (March 1966)), it is vitally important to keep other channels of distribution open for smaller producers. The sales-commission arrangement, however, by tending to shut out the smaller competitor from substantial portions of the service station market, extends and reinforces the market power of the major TBA producers.

The sales-commission promotional plan is without redeeming economic value.[8] The plain fact is that the TBA manufacturer is willing to pay substantial commissions to the major oil company in return for the latter's use of its economic power over its dealers to gain for the TBA manufacturer a share of the market it might not be able to obtain on the competitive merits of its own product; the effect is to exclude competing TBA sellers from a significant part of the

[8] See, generally, Note, *TBA Sales-Commission Contracts: A Time for Per Se Illegality*, 56 Geo. L.J. 557 (1968).

market. In these circumstances, the Commission was not obliged to show the exact degree of foreclosure which has resulted from the arrangement. It is enough that a substantial amount of commerce is involved. *Atlantic Refining, supra*, 381 U.S. at 371. Cf. *Northern Pacific Ry. Co. v. United States, supra*, 356 U.S. at 7; *International Salt Co. v. United States*, 332 U.S. 392.

CONCLUSION

For the foregoing reasons, the judgment of the court of appeals should be reversed and the case should be remanded to the court of appeals with directions to enforce the Commission's order, except for paragraphs 5 and 6 directed against Texaco (see note 4, *supra*, p. 9).

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